

## Internal Revenue Service

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Department of the Treasury  
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Date:  
January 26, 2009

### LEGEND

Trust =

Grantor =

Private =  
Foundation  
State =

Trustees =

Date =

n =

Dear :

In a letter dated September 11, 2008, and subsequent correspondence, your representative requested a ruling regarding the income tax consequences related to the transfer of appreciated securities as annuity payments described in a charitable lead annuity trust (CLAT) agreement. Specifically, your representative requested the following ruling: that if the annual payment to the Private Foundation by the Trust is satisfied with appreciated marketable securities, such payment will not trigger a gain or loss to Grantor or the Trust under Rev. Rul. 55-410, 1955-1 C.B. 297. This letter responds to that request.

## FACTS

The facts and representations submitted are summarized as follows: on Date, Grantor created the Trust under the laws of State and transferred to Trust a partial interest in a family owned limited liability company. The Trust was intended to qualify under § 2522(c)(2)(B) of the Internal Revenue Code as a CLAT. Under its terms, Trust must make a set annuity payment to the Private Foundation each year of n percent of the initial value of its assets for the term of twenty (20) years. At this time, the Trustees wish to disburse directly to the Private Foundation appreciated securities rather than disbursing from income.

The Trust contains the following relevant provisions:

Article III provides that the annuity amount shall be paid in equal annual installments from income, and to the extent income is not sufficient from principal. If the initial net fair market value of the trust assets is incorrectly determined, then, within a reasonable period after the value is finally determined for federal tax purposes, the trustee shall pay to the charitable organization (in the case of an undervaluation) or receive from the charitable organization (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

Article VI provides that no additional contributions shall be made to the trust after the initial contribution.

Article VII provides that the trustee shall not engage in any act of self-dealing within the meaning of § 4941(d), as modified by § 4947(a)(2), and shall not make any taxable expenditures within the meaning of § 4945(d), as modified by § 4947(a)(2). The trustee shall not retain any excess business holdings that would subject the trust to tax under § 4943, as modified by §§ 4947(a)(2) and 4947(b)(3), or retain assets which, if acquired by the trustee, would subject the Trustee to tax under § 4944, as modified by §§ 4947(a)(2) and 4947(b)(3).

Article X provides that the trust is irrevocable. However, the trustee shall have the power, acting alone, to amend the trust from time to time in any manner required for the sole purpose of ensuring that the annuity interest passing to the charitable organization is a guaranteed annuity interest under §§ 170(f)(2)(B), 2055(e)(2)(B), and 2522(c)(2)(B) and the regulations thereunder.

Article XIV provides that during the donor's life, the donor shall have the right, exercisable only in a nonfiduciary capacity and without the consent or approval of any

person acting in a fiduciary capacity, to acquire property held in the trust by substituting other property of equivalent value.

### STATEMENT OF THE LAW

Section 671 provides, in part, that where it is found in subpart E, part I of subchapter J, chapter 1, subtitle A of the Code that the grantor or another person shall be treated as the owner of any portion of a trust, then there shall be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in chapter 1 in computing taxable income or credits against the tax of an individual.

Section 675(4), found in subpart E, provides that the grantor shall be treated as the owner of any portion of a trust in respect of which a power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of § 675(4), the term “power of administration” includes a power to reacquire the trust corpus by substituting other property of an equivalent value.

In *Kenan v. Commissioner*, 114 F.2d 217 (2d Cir. 1940), the trustees of a testamentary trust were directed to pay the beneficiary five million dollars upon the beneficiary becoming forty-years-old. The trustees had a choice of whether to pay in cash or through securities and chose to pay part in cash and part in securities. The court held that the transfer of those securities resulted in a taxable exchange as the beneficiary had a claim against the trust for an ascertainable value. The court noted that the trustee exercising its choice to make a transfer from the corpus instead of selling the stock first, realizing gain, and then paying the beneficiary should not result in different tax consequences.

Rev. Rul. 83-75, 1983-1 C.B. 114, adopted the reasoning in *Kenan* and found that a distribution by a non-grantor irrevocable trust of appreciated securities in satisfaction of its obligation to pay a fixed annuity to a charitable organization resulted in a taxable gain to the trust. The Service noted that although the trustee had the authority to pay the annuity to qualified charities of the trustee’s choice, the distribution was a taxable exchange as it was made to satisfy a right to receive a specified dollar amount.

Rev. Proc. 2007-45, 2007-2 C.B. 89, provides guidelines for creating charitable lead annuity trusts including sample trust agreements as well as explanations of the various provisions in these sample agreements. It also describes some tax consequences to different actions involving these trusts. Rev. Proc. 2007-45, section 8.01(2) provides that the donor to a grantor charitable lead annuity trust may claim a federal income tax charitable deduction under § 170(a) in the year that assets are

irrevocably transferred to the trust. During the charitable lead annuity period, the donor is taxed on all income earned by the trust and does not receive any charitable deduction under § 170 for the annuity payments to the charitable beneficiary as they are made.

Section 170(f)(2)(B) provides, in part, that no deduction shall be allowed under § 170 for the value of any interest in property (other than a remainder interest) transferred in trust unless the interest is in the form of a guaranteed annuity or the trust instrument specifies that the interest is a fixed percentage distributed yearly of the fair market value of the trust property (to be determined yearly) and the grantor is treated as the owner of such interest for purposes of applying § 671.

Rev. Proc. 2007-45, section 8.02(2) states that if the trustee distributes appreciated property in satisfaction of the required annuity payment of a grantor charitable lead annuity trust, the donor will realize capital gain on the assets distributed to satisfy part or all of the annuity payment.

Rev. Rul. 55-410 provides that the satisfaction of a mere pledge to a charity with property that has either appreciated or depreciated in value does not give rise to a taxable gain or a deductible loss. The Service stated that it would be inconsistent to treat such payment or transfer as a “contribution or gift” and at the same time as a satisfaction of a debt with the tax consequences which would ordinarily follow from the use of appreciated or depreciated property to pay a debt.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that Grantor would recognize gain on the use of appreciated securities by the Trustees to make the annuity payments to the Private Foundation as required by the terms of the Trust.

Rev. Rul. 55-410 does not apply to this situation where the transfers are made from a CLAT to satisfy annuity payments. The charity has a claim against the CLAT's assets which would be satisfied by the transfer of the appreciated securities. See *Kenan* and Rev. Rul. 83-75. This is contrary to the reasoning in Rev. Rul. 55-410 which found that a pledge to a charity is not a debt. In addition, § 170(f)(2)(B) permits a charitable deduction upon the establishment and funding of the CLAT for the present value of the annuity interest given to the charity, even though payments equaling that value will not be made until the future. An individual making a pledge to a charity does not receive an income tax deduction until the pledge is satisfied by the transfer of property to the charity, therefore there are no income tax consequences on the creation of a pledge agreement as there are upon the creation of a CLAT.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury

statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/

James A. Quinn  
Senior Counsel, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

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